No. 12,806

In the United States Court of Appeals for the Ninth Circuit

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

WESTERN CONSTRUCTION COMPANY, RESPONDENT

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ALBIN JOHNSON, RESPONDENT

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ELLEN M. JOHNSON, RESPONDENT

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v.

HULDAH JOHNSON, RESPONDENT

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

GEORGE J. JOHNSON, RESPONDENT

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

J. A. JOHNSON, RESPONDENT

ON PETITIONS FOR REVIEW OF THE DECISIONS OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE PETITIONER

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OPINION BELOW

The only previous opinion (R. 655-696) is the opinion of the Tax Court, *en banc,* seven judges dissenting, which is reported in 14 T.C. 453.

JURISDICTION

The above entitled six cases were heard together in the Tax Court and a single opinion was rendered. The petition for review in the case of taxpayer Western Construction Company involves federal income, declared value excess profits and excess profits taxes for the four years 1942 through 1945, inclusive. The other five cases each involve federal income taxes for the three years 1943 through 1945, inclusive.

The Commissioner of Internal Revenue mailed to taxpayer Western Construction Company a notice of deficiency in income, declared value excess profits and excess profits taxes on May 29, 1947, in the respective amounts and for the respective years below stated as follows (R. 6, 11-22, 656):

Taxpayer	Year	Kind of Tax	Deficiency
Western Construction Company	1942	Income	$ 4,085.00
		Declared Value Excess Profits	49,390.07
		Excess Profits	255,736.68
	1943	Income	4,703.95
		Declared Value Excess Profits	43,432.61
		Excess Profits	223,777.92
	1944	Income	3,152.71
		Declared Value Excess Profits	6,677.60
		Excess Profits	27,574.04
	1945	Income	4,401.33
		Declared Value Excess Profits	18,253.17
		Excess Profits	87,647.08

The Commissioner of Internal Revenue mailed on May 29, 1947, to each of the remaining five taxpayers a notice of deficiency in income tax in the respective

amounts below stated for the years 1943, 1944, and 1945, as follows:

Taxpayer	Year	Amount of Deficiency	Record References
Albin Johnson	1943	$93,780.81	(R. 44, 52–62, 656.)
	1944	6,717.05	
	1945	23,177.99	
Ellen M. Johnson	1943	29,624.73	(R. 78, 84–93, 656.)
	1944	2,312.86	
	1945	6,529.81	
Huldah Johnson	1943	30,745.52	(R. 109, 115–124, 656.)
	1944	2,385.74	
	1945	6,681.15	
George J. Johnson	1943	29,872.23	(R. 140, 146–155, 656.)
	1944	2,320.75	
	1945	6,635.52	
J. A. Johnson	1943	29,111.03	(R. 171, 176–185, 657.)
	1944	2,262.40	
	1945	6,529.81	

Within ninety days thereafter and in each case on August 11, 1947, each of the above entitled six taxpayers filed a petition with the Tax Court for redetermination of the deficiencies above stated under the provisions of Section 272 of the Internal Revenue Code, as follows:

Taxpayer	Record References
Western Construction Company	(R. 3, 22.)
Albin Johnson	(R. 41, 62.)
Ellen M. Johnson	(R. 75, 93.)
Huldah Johnson	(R. 106, 124.)
George J. Johnson	(R. 137, 155.)
J. A. Johnson	(R. 167, 185.)

The final order and decision of the Tax Court was entered in the case of taxpayer Western Construction Company on July 14, 1950, determining that there are no deficiencies in income tax, declared value excess profits tax, and excess profits tax for the calendar years 1942, 1943, 1944 and 1945. (R. 35-36.)

The final order and decision of the Tax Court was entered in the case of each of the other five taxpayers on

July 14, 1950, determining that there is a deficiency or overpayment in income taxes on the part of each of the taxpayers below listed for the calendar years and amounts respectively below stated:

Taxpayer	Year	Amount of Deficiency Determination	Amount of overpayment Determination	Record References
Albin Johnson.....	1943	$9,311.96		(R. 68.)
	1944	834.40		
	1945	2,667.06		
Ellen M. Johnson.....	1943	3,348.71		(R. 99–100.)
	1944	357.89		
	1945		$232.81	
Huldah Johnson.....	1943	3,650.23		(R. 130.)
	1944	339.85		
	1945		228.79	
George J. Johnson.....	1943	2,815.43		(R. 161.)
	1944	322.38		
	1945		216.54	
J. A. Johnson.....	1943	2,886.91		(R. 191.)
	1944	357.89		
	1945		232.81	

The cases were brought to this Court by petitions for review filed by the Commissioner of Internal Revenue, in the case of each taxpayer, respectively, on October 9, 1950:

Taxpayer	Record References
Western Construction Company	(R. 37–39.)
Albin Johnson	(R. 69–72.)
Ellen M. Johnson	(R. 100–103.)
Huldah Johnson	(R. 131–134.)
George J. Johnson	(R. 162–165.)
J. A. Johnson	(R. 192–195.)

within three months after the Tax Court's decision was rendered, pursuant to the provisions of Section 1141 (a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948, and Section 1142 of the Internal Revenue Code. In the case of taxpayer Western Construction Company by stipulation in writing the Commissioner and the taxpayer, pursuant

to the provisions of Section 1141 (b) (2) of the Internal Revenue Code, designated that the decision of the Tax Court of the United States be reviewed by this Court. (R. 36.)

QUESTIONS PRESENTED

1. Whether the limited partnership, Western Construction Company, constituted an association taxable as a corporation.

2. In the alternative, if Western Construction Company is held not to be taxable as a corporation, then whether Western Construction Company was a partnership consisting only of the three general partners or, on the other hand, whether the Tax Court properly recognized the children of the three general partners as members of the firm, in addition to their respective fathers, the general partners.

STATUTES AND REGULATIONS INVOLVED

The statutes and Regulations involved will be found in the Appendix, *infra*.

STATEMENT

The decision below was reviewed by the entire Tax Court (R. 692), and was rendered by a closely divided court. Six judges joined in a dissenting opinion. (R. 693-696.) Judge Turner additionally dissented without opinion. (R. 692.)

The deficiencies determined by the Commissioner resulted from several adjustments to taxpayers' net income, as disclosed by their tax returns for the years in question. Most of these issues were settled by stipulation (R. 657), which left for consideration only two

issues. The first litigated issue was whether Western Construction Company was an association taxable as a corporation. (R. 657-658.) The second litigated issue was presented in the alternative, and arose only if the first issue was decided against the Commissioner, namely, in the event Western Construction Company was held not to be taxable as a corporation, but regarded taxwise as a partnership, then who were to be recognized as the firm members; did they include only the three fathers, the general partners, or also their several children, the so-called limited partners.

The Tax Court made findings based partly on stipulation (R. 197-201) and partly on evidence consisting of testimony and exhibits as follows (R. 659):

Taxpayer, Western Construction Company, was created as a limited partnership under the laws of the State of Washington, and filed partnership returns for the taxable years 1942 to 1945, inclusive. Taxpayers J. A. Johnson, George Johnson, and Albin Johnson are the three general partners of taxpayer Western Construction Company. Taxpayer Huldah Johnson is the wife of George Johnson and taxpayer Ellen Johnson is the wife of J. A. Johnson, and these taxpayers are involved solely because of their community property status with their husbands. (R. 660.) [1]

The three Johnsons are brothers. In 1909 George and J. A. formed a partnership, known as Johnson Brothers, to engage in the general construction busi-

[1] Lloyd Johnson, a son of George Johnson, and the former's wife, Roberta, were also parties to the proceeding in the Tax Court, but their deficiencies were adjusted by stipulation at the hearing (R. 660, 682), and hence, they are not parties to the instant appeal.

ness. In 1934 Albin was admitted to the partnership as an equal partner under an oral agreement and operated under the name of the Western Construction Company, with offices at Seattle, Washington. At first the partnership built small homes, but gradually expanded into larger lines of construction as its capital increased; however, the business was always run as a family affair. The sons of the partners worked for the company from their early teens during school vacations, and the daughters worked as clerks or stenographers prior to the taxable years involved herein. (R. 660-661.)

In 1935 the partnership suffered a large loss in connection with a contract for the construction of bridge piers at the Grand Coulee Dam in the State of Washington. From 1936 to 1940 the partnership did not actively engage in the construction business. However, it was not dissolved, but was kept alive for the purpose of paying off creditors and prosecuting its claims. (R. 661.)

To enable the partners to continue in business, obtain necessary loans, and pay off their indebtedness, the bank and the bonding company advised that they do business as a corporation. On October 9, 1935, a corporation was organized under the name of "Western Construction Company, Inc.", and continued business during the years 1936 to 1940. The bank insisted that the incorporators and officers of the corporation be two sons of the former partners and the bookkeeper. While the stock was issued to the sons, the beneficial owners were the three Johnson brothers. By 1941 the brothers prospered sufficiently to pay off the entire indebtedness

of Western Construction Company and of the three brother partners, incurred as a result of the Coulee Dam project. Thereupon it was decided to dissolve the corporation and revert to the partnership form of business. Prior to the dissolution, the incorporators turned over their stock to the three brothers, who then became the officers of the corporation. The dissolution was completed in 1942. (R. 661-662.)

During the time the corporation was in existence, J. A., George and Albin also did some business as general partners of the Western Construction Company. In 1940 they secured a very large contract, known as the West Park Housing project, at Bremerton, Washington, which was performed as a joint venture, composed of the three brothers and another individual because the partners did not have the financial backing themselves to secure the necessary bond. Subsequently it was discovered that the other joint venturer was of no real financial help to the partnership; nevertheless, the agreement required a split of the profits. In 1941 the partnership also received a contract for the Rainier Vista project. The contract was a financial success and was completed by Western Construction Company, the limited partnership and taxpayer herein. (R. 662-663.)

Early in 1941 the three brothers, who had no formal engineering training, discussed among themselves and with their three sons, the formation of a partnership consisting of fathers and sons. Two of the boys were graduate engineers, with considerable experience, and Albin's son, Winston, had attended engineering school for three years and had worked for his father and the

other Johnson brothers in the construction business. On January 6, 1941, articles of copartnership naming the six individuals as partners were prepared and executed by them. The agreement contemplated preserving in the three fathers the value of the assets then owned by the old partnership and allowing the sons to participate, without any capital investments, only in the increase in the value of the new partnership from the date of the agreement. The agreement also provided that each of the six partners should actively work for the partnership; that salaries should be determined and paid the six of them based upon services; and that thereafter the partnership profits would be divided equally among the six partners. This partnership, however, never actively operated and no books or accounts were ever set up for it. (R. 663-664.)

The three brothers were anxious to bring their children into the business, especially their sons, who had engineering training which the brothers lacked. Again, one of the big problems that confronted the brothers was that, largely because of their limited finances, they were unable to obtain bonds required in securing the large and more lucrative Government contracts. They endeavored to persuade other companies to join them on bids, but the West Park project at Bremerton indicated that this was not a satisfactory solution. They also tried unsuccessfully to get outsiders to invest in the partnership. Thus, faced with the desire to include their children in the business and with the need of additional financial backing, the brothers decided to form a limited partnership in which the brothers would be the general partners and their adult children the

limited partners. This decision was made without discussion with tax counsel, accountants, or attorneys as to whether it would be cheaper to do business as a partnership rather than as a corporation. (R. 664.)

The proposed partnership contemplated that each of the Johnson brothers would have a capital investment of $20,000 and the children of each of the brothers a like capital investment of $20,000, divided equally among the children becoming limited partners. On February 24, 1942, they formed a limited partnership, Western Construction Company, taxpayer herein, consisting of the three Johnson brothers as general partners, and seven limited partners, being their three adult sons and four adult daughters. (R. 664-665.)

The agreement, so far as relevant, read as follows (R. 665-669):

> Certificate of Formation of a Limited Partnership
>
> State of Washington
> County of King, ss:
>
> We [names of the general and limited partners] * * * having formed a limited co-partnership pursuant to the laws of the State of Washington, do hereby certify and state:
>
> I
>
> That the name of the co-partnership is Western Construction Company.
>
> II
>
> That the character of the business is general contracting.

III

That the location of the principal place of business and office is in the Textile Tower, City of Seattle, County of King, and State of Washington.

IV

* * * * *

[The names and residences of each member, general and limited partners, designated as such, are listed. All resided in Washington, except one daughter, a resident of Ohio.]

V

That the term for which the partnership shall exist is for ten (10) years from January 2nd, 1942.

VI

That the amount of cash contributed by each Limited Partner is as follows: $10,000 each, by each Limited Partner, except Roy W. Johnson, Eleanor J. Rector and Evelyn J. Borgens who contributed $6,666.66 each.

VII

The time when the contribution of each Limited Partner is to be returned, is agreed to be the end of said partnership as above stated, to wit, ten (10) years from January 2nd, 1942.

VIII

The share of proceeds by way of income which each Limited Partner shall receive by reason of his contribution, is as follows: The General Partners, and each of them, are to receive a salary per year, to be fixed by them in a reasonable amount to

cover their superintendence and management of the work and business, in proportion to the amount of work done by them, each year, taking into account the amount of the net profit of the partnership each year, never to exceed the sum of $15,000.00 a year salary to any one of the General Partners.

After the payment of said salaries to said General Partners and deduction of all other expenses of the partnership, the net income or proceeds shall be divided among the partners both general and limited on the basis of their financial interest in said partnership, as shown by the books of the partnership.

IX

The General Partners are hereby given the right to admit additional Limited Partners in the future upon the agreement of the General Partners hereto, but in no event other than upon a cash contribution to the partnership, and upon the same terms as herein expressed.

X

The entire management of the partnership shall be vested in the three General Partners and the right is hereby given to the remaining General Partners to continue the business upon the death or retirement of a General Partner, and the right is also given to the General Partners to continue the business upon the death or retirement of any of the Limited Partners hereto.

XI

It is understood and agreed between all of the partners that a Limited Partner shall not receive

out of partnership property any part of his contribution until all liabilities to the General Partners and Limited Partners on account of their contribution, have been paid or their [*sic*] remains property of the partnership sufficient to pay them.

XII

The interests of all the Limited Partners herein may be transferred upon the approval of the General Partners to accept a new assignee as a Limited Partner in this co-partnership, and not otherwise.

XIII

No General Partner shall demand or receive any property other than cash in return for his contribution and each General Partner's interest in this partnership shall be fixed as of the date of January 2nd, 1942, by the books of the co-partnership.

* * * * *

Pursuant to this agreement the partners and their capital accounts were as follows (R. 670):

General Partners:	Capital
Albin Johnson	$15,000.00
George Johnson	15,000.00
J. A. Johnson	15,000.00
Limited Partners:	
Albin's Children:	
Winston Johnson	10,000.00
Elsie Keil	10,000.00

George's Children:

Bernice Wallin	10,000.00
Lloyd Johnson	10,000.00

J. A.'s Children:

Roy Johnson	6,666.66
Eleanor Rector	6,666.66
Evelyn Jorgens	6,666.66

The limited partners made their cash contributions to the partnership with money they borrowed from their respective fathers. The fathers drew checks on moneys they had to their credit on the books of Western Construction Company and delivered these checks to their children. In return each child gave his or her promissory note payable to the father. Each limited partner then gave the limited partnership a check in the amount of the loan in payment of his or her limited partnership interest. The partnership itself did not thereby increase its assets; however, each of the general partners had in his possession $20,000 worth of notes signed by his children. These notes were never pledged as collateral for any loan, but they were listed as personal assets of the general partners in applications for construction bonds. On July 30, 1942, an additional $50,000 was borrowed from a bank. (R. 670-671.)

Each of the children knew and understood he was signing a note which was unconditionally payable and which represented a bona fide obligation on his part. They did not take on these obligations lightly as there was considerable discussion about the notes before signing them. While none of the husbands of the John-

son daughters signed any of these notes given to the general partners, generally speaking, the notes were signed by the wives with the knowledge and consent of their husbands. Rachel Gustafson, the daughter of George Johnson, was invited to participate in the first limited partnership. However, she declined to do so as both she and her husband did not desire to sign a note for $5,000. They knew that the construction business is subject to heavy losses, as well as handsome profits. Rachel had seen at first hand the Coulee Dam fiasco, with its resulting damaging effects to the partnership. Her husband had changed his course of study at the university from premedical to engineering at the urging of his father-in-law. When he graduated there was no work available in engineering, so he entered the meat business and at present is the owner of a butcher shop. (R. 671-672.)

Those notes did not provide that they were payable solely from business profits, but, on the contrary, there was a general understanding among the limited partners that they were entering a normal business transaction upon the signing of the notes. The financial situation of the limited partners of the 1942 partnership was good, and each had sufficient assets to cover his or her liability on the notes. This was especially true of the three sons of the respective general partners. Two of the sons had already achieved considerable prominence and success in the business world. Though the sons-in-law did not sign the notes, they treated these obligations as resting on their community property. An example of all the notes which were given by the limited partners to their fathers is the

note of Eleanor J. Rector given to her father, J. A. Johnson. It reads as follows (R. 672-673):

> $6,666.66 Seattle, Wash. April 21st, 1942
>
> One year after date, without grace, for value received I promise to pay to the order of J. A. Johnson Six Thousand Six Hundred Sixty-six Dollars and Sixty-seven Cents, in Lawful Money of the United States of America, of the present standard value, with interest thereon in like Lawful Money, at the rate of 4 per cent per annum from date until paid. Interest to be paid at maturity and if not so paid, the whole sum of both principal and interest to become immediately due and collectible at the option of the holder of this note. And in case suit or action is instituted to collect this note or any portion thereof I promise and agree to pay in addition to the costs and disbursements provided by statute such sum as the court may adjudge reasonable as attorney's fees in said suit.
>
> Due April 21st, 1943.
>
> [S.] Eleanor J. Rector.

When other children of the general partners found that their brothers and sisters had done so well in the 1942 partnership they too wanted to acquire an interest for themselves. (R. 674-675.) On June 30, 1943, a new limited partnership was formed on substantially the same basis as the former one, excepting that three additional children were brought into the partnership as limited partners, namely, two daughters of George Johnson, and a daughter of Albin Johnson. The capital of the general partners remained at $20,000 each. (R. 673.) The capital of the limited partners was

changed by consent of all parties as follows (R. 673-674):

	Capital
Albin's children:	
Winston Johnson	$6,666.66
Elsie Keil	6,666.66
Vedola Johnson	6,666.66
George's children:	
Bernice Wallin	5,000.00
Lloyd Johnson	5,000.00
Betty Ellingson	5,000.00
Rachel Gustafson	5,000.00
J. A.'s children:	
Roy Johnson	6,666.66
Eleanor Rector	6,666.66
Evelyn Jorgens	6,666.66

None of the new partners made a direct contribution of capital to the partnership. Rachel Gustafson and Betty Lorraine Ellingson (daughters of George) each obtained a division of the interests which had been held in the names of their sister and brother, Bernice Wallin and Lloyd Johnson. This was accomplished by the unpaid notes of the latter partner being returned to them by their father and new notes in the amount of $5,000 being given by each of the four children to their father. Vedola Johnson (daughter of Albin) was taken in as a limited partner in the same way as Rachel Gustafson and Betty Lorraine Ellingson, daughters of George, were taken in. Her brother Winston and sister Elsie Keil had their notes for $10,000 each returned

to them and each executed a note for $6,666.66, payable to their father. (R. 674.)

The interests of the three Johnson families were always kept equal in the various partnerships. (R. 675.)

The moneys which these adult children borrowed from their fathers and used to invest in the limited partnership were bona fide loans. The general partners had minor children, but they were not taken into the partnership because they wanted notes from adults, fully responsible for payment. The notes were negotiable, bore interest, and were all for short terms not exceeding two years, except the first two notes of Lloyd Johnson and his sister Bernice Wallin to their father George Johnson for $10,000 each. These notes were installment notes, payable in yearly installments of not less than $3,500 in any one payment. Some of the notes given by the limited partners were paid in 1945. Lloyd paid his note in 1946; Winston and Elsie paid their notes in 1947. Rachel has not paid her note, as no demand has been made for payment from her by her father. (R. 675.)

The limited partnership was not the result of an impulse set off by the desire to minimize taxes, but rather the result of many years of thought by the general partners, who were anxious to have their sons, daughters, and sons-in-law come into the business so that it would continue after the general partners retired or died. (R. 676.)

Just prior to the formation of the partnership it appeared that Lloyd and Roy were drifting away from the business to other attractive jobs. Their talents

and training were in demand by others. For some years prior to 1942 Lloyd had worked for various individuals and companies other than Western Construction Company. In 1941, Lloyd, contrary to his father's wishes, formed a construction partnership with Max J. Kuney of Spokane, Washington, in which each had a one-half interest. When the Kuney-Johnson partnership was formed there was no plan for its being a permanent association, but that partnership opened offices in Seattle, Washington, and has been successfully active in the construction business from that time down to the present. Lloyd did not work as an employee of the limited partnership, but he did perform important services for the firm. He was a graduate engineer, with a great deal of experience. In 1942 and 1943 he was consulted by the general partners on matters relating to pricing and estimating pricing jobs, figuring bids, and helping them get scarce materials such as nails which were almost impossible to get. Pricing was a very important work during the war years because prices changed so fast. The partners telephoned Lloyd a great deal on business matters of the company. He also did a great deal of night work helping the general partners on matters relating to engineering, bids, and estimates. He did not receive any compensation for this work, but he devoted a considerable amount of his time because of his interest as a limited partner. It was of great value to the partnership. (R. 676-677.)

Roy Johnson was engaged for many years prior to 1942 in businesses other than that of the Western Construction Company. He rendered no regular services to the limited partnership until January, 1943, when

he devoted full time to its affairs. In 1942 he assisted the partnership by advising it on estimates and by performing engineering work for it. From January, 1943, until June, 1944, Roy worked full time for the partnership and was paid a salary of $2.05 an hour. During this period he worked as an engineer designing layout foundations, excavating footings, roads, buildings, arches and superintending both large and small jobs. He estimated various projects and did some difficult engineering work which the general partners could not do. In June, 1944, Roy went to Alaska to assist with a hydroelectric project. He remained there until the fall of 1947, working on this project, which had no connections with the Western Construction Company. (R. 677-678.)

Winston Johnson, son of Albin Johnson, worked for the partnership at all times after March, 1942, when he was released from the army. Winston, who had three years of college training as a civil engineer, did various types of work for the firm. He worked in the office, estimated jobs, obtained materials, arranged subcontracts, represented the partnership before the Navy on problems relating to contracts, and supervised jobs. His pay for this work was $80 or $90 a week which was somewhat below the standard for estimators some of whom earned $30,000 a year working on a salary plus bonus basis. (R. 678.)

The daughters did not render any services to the limited partnership of any substantial consequence. (R. 678.)

With the exception of Harold Ellingson, Betty's husband, none of the sons-in-law worked for the limited

partnership, and Ellingson worked as a carpenter, for only three months of the taxable years here involved. The general partners hoped that some day most of the sons-in-law would be associated with the partnership. (R. 678.)

The limited partnerships were very successful and made large net profits, which were credited each year to the partners on the basis of their capital accounts. In determining net profits there was first subtracted $15,000 for each general partner as salary. The 1942 profits were several times more than the expectations of the general partners, and the crediting of profits to each partner was more than three and one-half times his capital account; however, the construction business represents a hazardous financial risk and it is possible to lose heavily as well as to realize large profits. (R. 675.)

The partnership reported its profits for tax purposes upon a completed contract basis. This was true of the Quartermaster and Rainier Vista contracts, which were under way by the time the first partnership was created. Gross profits were realized upon the Quartermaster and Rainier Vista contracts in the respective amounts of $234,886.20 and $201,754.39, which were reflected in the 1942 return of the limited partnership. Division of such profits was made with the limited partners on the basis of their stated partnership interests. (R. 676.)

The partnership profits were regarded by all of the limited partners and their spouses as community property and in the filing of their returns for the years 1942 to 1945 inclusive, such profits were divided in the

returns of the spouses on a community property basis the same as other income. Substantially all of the returns of the limited partners and their spouses for the years 1942 to 1945, inclusive, were prepared at the office of the Western Construction Company by the accountant who handled the affairs of the partnership. (R. 678-679.)

Partnership checks representing distribution of profits were sometimes made out to the limited partners, and sometimes to the spouses of the limited partners, depending upon which one requested the money. It was regarded as a family business and no distinction was made as between limited partners or his or her spouse when it came to distributing the profits. There were no profits credited to the account of the limited partners and no withdrawals by them until after the close of the taxable year ended December 31, 1942. The limited partners were entitled to withdraw their share of the profits as they pleased and the shares of the profits credited to the individual partners' accounts were in no way considered to be anything but their own property. No limited partners ever withdrew any profits and turned them over in any way to the father, the general partner. No limited partner was in any way dependent upon his or her father, the general partner, for support either at the time of the formation of the partnership or later. (R. 679.)

The freedom of withdrawals by the limited partners without consulting the general partners is illustrated by the various uses they made of their profits. Roy Johnson in 1945 withdrew $40,000 to invest in his own construction project in Alaska. At one time he over-

drew $6,600 for working capital in his Alaskan project, which he returned when the bookkeeper notified him of that fact. Winston Johnson withdrew $2,333.50 to pay for an engagement ring, the cost of his honeymoon, his mother's funeral expenses, and personal items. He also withdrew $2,700 to purchase a lot for his home and later $36,509.69 to invest in the stock of another company. Lloyd Johnson withdrew $9,000 of his profits to invest in a restaurant. The greater portion of his withdrawals were for uses other than the payment of income taxes. Elsie Keil used some of her profits to pay personal bills and also withdrew $49,976.52 to buy stock in another company. Vedola Johnson withdrew $6,586 of her profits to purchase stock in another company. Evelyn Jorgens invested $8,500 of her profits in a chicken ranch. Rachel Gustafson made withdrawals only to pay income taxes, as she had no other need for the money. Bernice Wallin withdrew $5,000 of her profits to invest in a real estate business and made a number of other personal withdrawals. Betty Ellingson used some of her profits for personal expenses. (R. 679-680.)

The three general partners managed the limited partnership in the same manner that they had the business which preceded the limited partnership. As general partners, the management and direction of the business was in their hands and all their personal assets, including the notes of the limited partners, were subject to possible loss in the event the limited partnership failed. The sons who were limited partners worked under the direction of the general partners. Only the

general partners could sign checks or notes for Western Construction Company. (R. 680-681.)

There was no delegation of authority by the limited partners to the general partners. The limited partners held no meetings regarding such delegation of authority, elected no officers and representatives, and received no certificates or other evidence of their contribution as limited partners, other than the partnership articles. (R. 681.)

The limited partnerships were not operated with any of the usual formalities of a corporation or association. There were no officers, no regular or formal meetings, no bylaws, board of directors, seal, or minute books. The Western Construction Company held itself out to the public as a true limited partnership. The parties to the limited partnership agreements here involved formed a bona fide partnership and truly intended to join together for the purpose of carrying on the business as a partnership. It was not an association taxable as a corporation. Proper statutory notice of the formation of both limited partnerships was given. The limited partnership agreements provided that the general partners could admit additional limited partners and continue the business upon the death or retirement of a general or limited partner. Those rights could be exercised only by agreement among the general partners. (R. 681-682.)

Based upon these findings the majority of the Tax Court in an opinion by Judge Black held against the Commissioner on both issues. On the first issue (R. 683-687), on the authority of its earlier decision in

Glensder Textile Co. v. *Commissioner,* 46 B.T.A. 176, the majority of the tribunal below ruled substantially without discussion here that Western Construction Company was not an association taxable as a corporation (R. 686-687). On the alternative issue (R. 687-692), the majority held that, looking at the evidence as a whole, Western Construction Company was intended and created as a valid business partnership including all the limited partners and must therefore be recognized as such for tax purposes (R. 692).

Judge Turner dissented without opinion. (R. 692.) Judge Opper dissented in an opinion in which five other judges joined. (R. 693-696.) Accordingly, the Tax Court in its ruling below was closely divided. Assuming all sixteen judges passed on the instant case, the majority opinion represents the views of nine judges as opposed to seven in dissent.

From the adverse decisions of the Tax Court, entered upon this close division of opinion below, the Commissioner seeks the instant review by this Court.

STATEMENT OF POINTS TO BE URGED

I

With respect to taxpayer Western Construction Company, the Tax Court erred (R. 39-40):

1. In entering its decision that there are no deficiencies in income tax, declared value excess profits tax and excess profits tax for the calendar years 1942, 1943, 1944 and 1945.

2. In failing and refusing to sustain the deficiencies in tax determined by the Commissioner insofar as such

deficiencies resulted from his determination that taxpayer was, during the taxable years involved, an association taxable as a corporation.

3. In holding and deciding that the taxpayer does not resemble an association in corporate form and is, therefore, not taxable as a corporation.

4. In failing and refusing to hold and decide, as determined by the Commissioner, that the taxpayer, under the so-called limited partnership agreements of February 24, 1942, and June 30, 1943, constituted an association taxable as a corporation as prescribed by Section 3797 (a) (3) of the Internal Revenue Code and the Commissioner's regulations.

5. In that its ultimate finding that the taxpayer was not an association taxable as a corporation and its opinion and its decision are not supported by but are contrary to the evidence.

6. In that its opinion and its decision are contrary to law and the Commissioner's Regulations.

II

With respect to the remaining five individual taxpayers the Tax Court in each case erred (R. 73-74, 104-105, 135-136, 166-167, 196-197):

7. In holding and deciding that the Western Construction Company is a bona fide partnership composed of the three Johnson brothers and their several children as set out in the certificate of formation of the partnership and is recognized as such for tax purposes.

8. In failing and refusing to hold and decide that the Western Construction Company, during the taxable

years involved, was a partnership consisting only of its three general partners, and that for federal income tax purposes the income of such partnership was taxable to the general partners and their respective spouses and that the children of the general partners should not be recognized, for federal income tax purposes, as bona fide partners in the business conducted by the Western Construction Company.

9. In that its opinion and its decision that, for federal income tax purposes, the Western Construction Company is a bona fide partnership composed of the three Johnson brothers and their several children as set out in the certificate of formation of the partnership are not supported by but are contrary to the evidence.

10. In that its opinion and its decision are not supported by but are contrary to the evidence.

11. In that its opinion and its decision are contrary to law and the Commissioner's Regulations.

III

In the case of taxpayer Albin Johnson the Tax Court further erred (R. 72-73):

12. In entering its decision that there are deficiencies in income tax for the calendar years 1943, 1944 and 1945 in the respective amounts of only $9,311.96, $834.40 and $2,669.06.

13. In failing and refusing to sustain the deficiencies in tax determined by the Commissioner on the basis that the taxpayer was taxable upon one-third of the net income of the business conducted under the name of Western Construction Company, less the community

portion of such income allocable to taxpayer's wife, as modified by stipulation and agreement of the parties in respect of items not now in controversy.

In the case of taxpayer Ellen M. Johnson the Tax Court further erred (R. 104):

14. In entering its decision that there are deficiencies in income tax for the calendar years 1943 and 1944, in the respective amounts of only $3,348.71 and $357.89, and that there is an overpayment in income tax for the calendar year 1945, in the amount of $232.81.

15. In failing and refusing to sustain the deficiencies in tax determined by the Commissioner on the basis that the taxpayer's husband, J. A. Johnson, was taxable upon one-third of the net income of the business conducted under the name of Western Construction Company, less the community portion of such income allocable to the taxpayer, Ellen M. Johnson, the wife of J. A. Johnson, as modified by stipulation and agreement of the parties in respect of items not now in controversy.

In the case of taxpayer Huldah Johnson the Tax Court further erred (R. 134-135):

16. In entering its decision that there are deficiencies in income tax for the calendar years 1943 and 1944 in the respective amounts of only $3,650.23 and $339.85, and that there is an overpayment in income tax for the calendar year 1945 in the amount of $228.79.

17. In failing and refusing to sustain the deficiencies in tax determined by the Commissioner on the basis that the taxpayer's husband, George J. Johnson, was taxable upon one-third of the net income of the business

conducted under the name of Western Construction Company, less the community portion of such income allocable to the taxpayer, Huldah Johnson, the wife of George J. Johnson, as modified by stipulation and agreement of the parties in respect of items not now in controversy.

In the case of taxpayer George J. Johnson the Tax Court further erred (R. 165-166):

18. In entering its decision that there are deficiencies in income tax for the calendar years 1943 and 1944 in the respective amounts of only $2,815.43 and $322.38, and that there is an overpayment in income tax for the calendar year 1945 in the amount of $216.54.

19. In failing and refusing to sustain the deficiencies in tax determined by the Commissioner on the basis that the taxpayer was taxable upon one-third of the net income of the business conducted under the name of Western Construction Company, less the community portion of such income allocable to taxpayer's wife, as modified by stipulation and agreement of the parties in respect of items not now in controversy.

In the case of taxpayer J. A. Johnson the Tax Court further erred (R. 195-196):

20. In entering its decision that there are deficiencies in income tax for the calendar years 1943 and 1944 in the respective amounts of only $2,886.91 and $357.89, and that there is an overpayment in income tax for the calendar year 1945 in the amount of $232.81.

21. In failing and refusing to sustain the deficiencies in tax determined by the Commissioner on the basis

that the taxpayer was taxable upon one-third of the net income of the business conducted under the name of Western Construction Company, less the community portion of such income allocable to taxpayer's wife, as modified by stipulation and agreement of the parties in respect of items not now in controversy.

SUMMARY OF ARGUMENT

The two issues which these proceedings present are in the alternative. The first question is whether taxpayer, Western Construction Company, is an association taxable as a corporation. If this question is answered in the affirmative and the Court holds in accord with the Government's contention that the Western Construction Company is taxable as a corporation, the second question is not reached for consideration.

1. The mandate of the statute, as construed by the highest authority, requires taxation of Western Construction Company as an association taxable as a corporation. The scope of review by this Court on that issue is not limited, since the question presented is one of law, namely, of application of the taxing statute, Treasury Regulations, and judicial authorities to undisputed and principally documentary facts. Moreover, the majority of the Tax Court ruled on the question, not as a fact question tied to the particularities of the instant record, but on a point of law regarded by it as settled by its prior decision in a case which involved a different record, a different limited partnership and a different state statute. The ruling of the Tax Court majority was instantly not based upon any factual judgment but upon an opinion—mistaken as we contend—

that denial of the Commissioner's contention was required as a matter of law.

A business enterprise which has obtained most of the organizational advantages of incorporation should be taxed as a corporation. The legislative purpose is clearly to place in the same tax category, business organizations essentially of the same character, regardless of formal technicality.

The legislative inclusion of associations with corporations implies resemblance, but it is resemblance and not identity. The instant business enterprise indisputably meets two basic corporate criteria, namely, (1) association in a common enterprise, and (2) for the purpose of carrying on a business. Moreover, additionally the business enterprise, Western Construction Company, obtained through agreement of the parties participant powers granted in the limited partnership certificate filed in a public office, the essential organizational advantages of incorporation. Thus, (1) it possessed the capacity, as a unit, to acquire, hold, and dispose of property, and to deal with its property separate from its members' individual property. (2) Management of its affairs was centralized in the three general partners acting in a representative capacity. (3) By means of a special agreement and powers conferred in the limited partnership certificate, continuity of the business was assured notwithstanding the death or retirement of a general or limited partner. Indeed, the record establishs the conscious purpose of both the general and the limited partners for the business to continue after the general partners retired or died and the limited partnership was clearly given the power and

deliberately shaped to carry out this purpose. Where parties operate under an instrument, their relationship is governed by the powers conferred by the instrument rather than by what the parties may have done in exercise of the conferred powers. (4) Reasonable transferability of beneficial interests was also provided substantially identical to that commonly obtained in formally incorporated close family businesses. (5) The liability of the special partners was limited to the amount of their investment as in the case of stockholders. Under the authorities complete limitation of all beneficiaries' liability is not requisite to corporate classfication for taxpayers.

In summary, if the general partners are thought of as common stockholders and the special partners as holders of participating preferred stock, the entire arrangement is identical with a corporate structure, except for the unlimited liability of the general partners.

Finally, special provisions of the controlling Washington law add to taxpayer's corporate resemblance.

2. Alternatively, Western Construction Company fails to bear any resemblance to an actual partnership of which the limited partners were component members. If the limited partners (resembling preferred stockholders) are not associated with the general partners (resembling common stockholders) in an enterprise taxable as a corporation, then the so-called limited partners are not actual participants in the business at all. Their role then is merely that of partial assignees of their respective fathers' income and the so-called limited partnership is taxwise—so far as the children are concerned—merely an arrangement for anticipa-

tory assignment of income. Under such circumstances the finding of the Tax Court majority that all the parties formed a bona fide partnership and intended to join together for the purpose of carrying on a partnership business is clearly erroneous. There was no change in the operation or management of the business after the formation of the limited partnership, the daughters performed no services, and such services as the sons performed were under the direction of the general partners. Furthermore, the notes given by the children were not owned or used by the partnership as such, but constituted separate assets of the three individual general partners to whom they were payable. The conclusion of the Tax Court that possession of these notes was a factor of considerable importance to the financial status of the general partners and through them to the limited partnership, is clearly erroneous, in view, among others, of the finding that the notes were never pledged as collateral, but were merely listed as personal assets of the general partners in application for construction bonds. Further, two large government contracts were partially completed when the first limited partnership agreement was executed, yet all profits were divided and the amounts credited to the children were out of reasonable proportion to their stated capital contributions. The total cost of each of the two government contracts was eventually between a million and a quarter and a million and a half dollars and the aggregate profits inuring from them in the first year of the limited partnership exceeded $436,000. In view of the foregoing, it seems clear error for the Tax Court to have found that the $60,000 credit, which the children contributed in

this unusual and circuitous manner, was of any substantial importance to the financial status of the business or of the general partners, and to have concluded that the partnership possessed reality as to the limited partners.

ARGUMENT

I

The Issues

The significant tax problem, which the instant case presents, finds apt expression in the dissenting opinion as follows (R. 693):

> For the first time since *Tower, Lusthaus* and *Culbertson,* this case raises the question whether a family enterprise cast in the form of a limited partnership, just because it truly represents an actual form of doing business, is not in reality more nearly like a corporation than any other business organism.

The two issues which these proceedings present are in the alternative. (R. 659, 682.) The first question is whether taxpayer, Western Construction Company, is an association taxable as a corporation. If this Court should answer this first question in the affirmative and hold in accord with the Commissioner's contention that Western Construction Company is taxable as a corporation, the second question will not be reached and need not here be considered.

On the other hand, if this Court should decide on the first issue that Western Construction Company is not taxable as a corporation but is instead a partnership, then alternatively the second question is presented,

namely, the correct composition of the partnership for tax purposes, that is, whether the partnership, Western Construction Company, consisted, as the Commissioner contends, only of the three general partners, or, on the other hand, whether the Tax Court properly recognized the children of the three general partners additionally as members of the firm.[2]

The two alternative issues, however, possess a common character, which the dissenting opinion further points out, as follows (R. 693):

> The two issues before us cannot be neatly severed, so that we can separately deal with the reality of the partnership and its resemblance to a corporation. * * * The very aspects upon which peti-

[2] The Commissioner pointed out below that he had made inconsistent determinations in holding that Western Construction Company was an association taxable as a corporation, and at the same time determining that the same business during the same period was a general partnership composed of three members, and conceded that both determinations cannot stand. (R. 682.) Thus, in protection of the revenue only and not with the intention of ultimately taxing the same income to more than one of the taxpayers, the Commissioner has included the same income in determining the tax liability asserted against Western Construction Company as an association taxable as a corporation and also alternatively against the individual partners. Accordingly, in the event of reversal by this Court of the decision below on either one of the alternative two issues, necessary adjustments to avoid duplication in inclusion of income, as heretofore protectively determined by the Commissioner with respect to the several taxpayers, will be required to be made in the Tax Court under its Rule 50.

The aggregate deficiencies which the Commissioner determined against each taxpayer were as follows:

Western Construction Company	$728,832.16
Albin Johnson	123,675.85
Ellen Johnson	38,467.40
Huldah Johnson	39,812.41
George J. Johnson	38,828.50
J. A. Johnson	37,903.24

The items, which compose these aggregates, are set forth as to year and kind of taxes under Jurisdiction, *supra*. (See also R. 656-657.)

tioners rely to strengthen their claim of a valid partnership and yet to explain the relation to the business of the "limited partners" are in fact and in essence the *Morrissey* type of corporate characteristics.

II

The Mandate of the Controlling Statute, as Construed by the Highest Authority, Requires Taxation of the Business organization, Western Construction Company, as an Association Taxable as a Corporation

A. *The error asserted is an error in law*

The scope of review by this Court of the ruling below on the instant issue is not limited, since the question presented is one of law. The conclusion by the Tax Court that Western Construction Company was not an association taxable as a corporation on the instant record presents a question of law and not of fact for review by this Court.

1. The facts with respect to this issue are not in dispute and no question of credibility was decided by the tribunal below. Essentially the problem is one of the legal effect of the limited partnership agreement whose terms are documentary and set forth in the filed certificate of its formation, incorporated in the Tax Court's findings (R. 665-669) and quoted in the Statement, *supra*. Thus, the problem is one of application of the taxing statute, Treasury Regulations and judicial authorities to undisputed facts. Indeed, this Court has repeatedly viewed this issue, namely, whether a given taxpayer constitutes an association taxable as a corporation within the meaning of the Internal Revenue Code, as presenting a question of law and reversed lower court holdings, passing upon it when regarded

as incorrect, for error in law. Thus, in *United States* v. *Homecrest Tract,* 160 F. 2d 150, this Court, reversing a contrary holding of the District Court, ruled that a trust there constituted an association taxable as a corporation and said (p. 153):

> In the instant case the bulk of the record stands on documentary and stipulated evidence. The oral evidence adduced at the trial is not conflicting, nor does it present a question of credibility of the story teller. So the facts are not in dispute. The problem is one of construction of the trust instrument and the application of the taxing statute. The findings of the district court bring this transaction within the express terms of the taxing statute as it is interpreted by the noted regulation.

To the same effect are the earlier decisions of this Court in *Commissioner* v. *Vandegrift R. & Inv. Co.,* 82 F. 2d 387, 390; *Commissioner* v. *Fortney Oil Co.,* 125 F. 2d 995; *Helm & Smith Syndicate* v. *Commissioner,* 136 F. 2d 440; and *Commissioner* v. *Security-First Nat. Bank,* 148 F. 2d 937. See also *Wabash Oil & Gas Ass'n* v. *Commissioner,* 160 F. 2d 658 (C.A. 1st), certiorari denied, 331 U.S. 843, where the Court of Appeals for the First Circuit recognized that this Court treats the instant issue as one of law.

2. Moreover, the Tax Court itself ruled on the question as one of law and not of fact, for, as already pointed out in the Statement, *supra,* the holding adverse to the Commissioner's contention was here made on the authority of a prior decision of the tribunal below in *Glensder Textile Co.* v. *Commissioner,* 46 B.T.A. 176.

(R. 686-687.) Thus, the Tax Court resolved the issue here, not as a fact question tied to the particularities of the instant record, but on a point of law, regarded by it as settled by its prior cited decision in a case which involved a different record, a different limited partnership, and a different state statute. The ruling of the Tax Court instantly thus was not based upon any factual judgment or factual conclusion but upon a conviction—mistaken as we contend—that denial of the Commissioner's contention was required as a matter of law. Indeed, even during the period when *Dobson* v. *Commissioner,* 320 U.S. 489, rehearing denied, 321 U.S. 231, controlled (prior to its legislative overruling by amendment of Section 1141 (a) of the Internal Revenue Code by Section 36 of the Act of June 25, 1948, c. 646, 62 Stat. 869), such a ruling by the Tax Court was held to raise a question of law, subject to full appellate review. *Commissioner* v. *Heininger,* 320 U.S. 467, 475.

B. *The governing legal principles*

The basic legislative purpose in classifying "associations" as corporations is to place in the same tax category organizations of essentially the same character, regardless of formal technicality. A business enterprise, which obtains most of the organizational advantages of incorporation, should be taxed as a corporation. Hence, the fundamental question in a given case is whether taxpayer by agreement or by certificate filed pursuant to state statute or otherwise has achieved an organization possessing the advantages, which typically follow corporate charter.

The controlling Internal Revenue Code contains the following definitions which, indeed, had previously been enacted repeatedly in earlier Revenue Acts (Appendix, *infra*):

> SEC. 3797. DEFINITIONS.
>
> (a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—
>
> * * * * *
>
> (2) *Partnership and Partner.*—The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, *and which is not, within the meaning of this title,* a trust or estate or *a corporation;* and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.
>
> (3) *Corporation.—The term "corporation" includes associations,* joint-stock companies, and insurance companies. (Italics supplied.)[3]

Long standing Treasury Regulations quoted in the footnote,[4] correctly mark out the statutory meaning.

[3] Congress first enacted the quoted definition of "Partnership and Partner" in the Revenue Act of 1932, c. 209, 47 Stat. 169, Sec. 1111 (a)(3), and the quoted definition of "Corporation" in the Revenue Act of 1918, c. 18, 40 Stat. 1057, Sec. 1.

[4] Treasury Regulations 111 (Appendix, *infra*):

> SEC. 29.3797-1. *Classification of Taxables.*—For the purpose of taxation the Internal Revenue Code makes its own classification and prescribes its own standards of classification. * * * The term "corporation" is not limited to the artificial entity usually known as a corporation, but includes also an association, a trust classed as an association because of its nature or its activities, a joint-stock company, an insurance company,

See also Treasury Regulations 111, Section 29.3797-3 (Appendix, *infra*). On familiar principles these Treasury Regulations continued without substantial change and applying to unamended or substantially reenacted statutory language are deemed to have received congressional approval and to possess the force

and certain kinds of partnerships. (See sections 29.3797-2 and 29.3797-4.) The definitions, terms, and classifications, as set forth in section 3797, shall have the same respective meaning and scope in these regulations.

SEC. 29.3797-2. *Association.*—The term "association" is not used in the Internal Revenue Code in any narrow or technical sense. It includes any organization, created for the transaction of designated affairs, or the attainment of some object, which, like a corporation, continues notwithstanding that its members or participants change, and the affairs of which, like corporate affairs, are conducted by a single individual, a committee, a board, or some other group, acting in a representative capacity. It is immaterial whether such organization is created by an agreement, a declaration of trust, a statute, or otherwise. It includes a voluntary association, a joint-stock association or company, a "business" trust, a "Massachusetts" trust, a "common law" trust, an "investment" trust (whether of the fixed or the management type), an interinsurance exchange operating through an attorney in fact, a partnership association, and any other type of organization (by whatever name known) which is not, within the meaning of the Code, a trust or an estate, or a partnership. If the conduct of the affairs of a corporation continues after the expiration of its charter, or the termination of its existence, it becomes an association.

* * * * *

SEC. 29.3797-4. *Partnerships.*—The Internal Revenue Code provides its own concept of a partnership. Under the term "partnership" it includes not only a partnership as known at common law, but, as well, a syndicate, group, pool, joint venture, or other unincorporated organization which carries on any business, financial operation, or venture, and which is not, within the meaning of the Code, a trust, estate, or a corporation. On the other hand the Code classifies under the term "corporation" an association or joint-stock company, the members of which may be subject to the personal liability of partners. If an organization is not interrupted by the death of a member or by a change in ownership of a participating interest during the agreed period of its existence, and its management is centralized in one or more persons in their

of law. *Morrissey* v. *Commissioner,* 296 U.S. 344, 355-356; *Taft* v. *Commissioner,* 304 U.S. 351, 357; *Helvering* v. *Winmill,* 305 U.S. 79, 83; *Boehm* v. *Commissioner,* 326 U.S. 287, 291-292, rehearing denied, 326 U.S. 811.

Furthermore, the Supreme Court afforded authoritative construction of the governing statutory language

representative capacities, such an organization is an association, taxable as a corporation. As to the characteristics of an association, see also sections 29.3797-2 and 29.3797-3. The following examples will illustrate some phases of these distinctions:

(1) If A and B buy some acreage for the purpose of subdivision, they are joint adventurers, and the joint venture is classified by the Code as a partnership.

(2) A, B, and C contribute $10,000 each for the purpose of buying and selling real estate. If A, B, C, or D, an outside party (or any combination of them as long as the approval of each participant is not required for syndicate action), takes control of the money, property, and business of the enterprise, and the syndicate is not terminated on the death of any of the participants, the syndicate is classified as an association.

SEC. 29.3797-5. *Limited Partnerships.*—A limited partnership is classified for the purpose of the Internal Revenue Code as an ordinary partnership, or, on the other hand, as an association taxable as a corporation, depending upon its character in certain material respects. If the organization is not interrupted by the death of a general partner or by a change in the ownership of his participating interest, and if the management of its affairs is centralized in one or more persons acting in a representative capacity, it is taxable as a corporation. For want of these essential characteristics, a limited partnership is to be considered as an ordinary partnership notwithstanding other characteristics conferred upon it by local law.

The Uniform Limited Partnership Act has been adopted in several States. A limited partnership organized under the provisions of that Act may be either an association or a partnership depending upon whether or not in the particular case the essential characteristics of an association exist.

SEC. 29.3797-6. *Partnership Associations.*—A partnership association of the type authorized by the statutes of several States, such, for instance, as those of the State of Pennsylvania (Purdon's Penna, Stat. Ann., (Perm. Ed.), Title 59, ch. 3), having by virtue of the statutory provisions under which it was organized, the characteristics essential to an association within the meaning of the Internal Revenue Code, is taxable as a corporation.

and expounded the principles which must here control in its leading decision in *Morrissey* v. *Commissioner,* 296 U.S. 344, *supra,* and three companion cases (*Swanson* v. *Commissioner,* 296 U.S. 362; *Helvering* v. *Combs,* 296 U.S. 365; and *Helvering* v. *Coleman-Gilbert,* 296 U.S. 369).[5]

The *Morrissey* case emphasizes that (p. 357):

> The inclusion of associations with corporations implies resemblance; *but it is resemblance and not identity.* (Italics supplied.)

Both the Tax Court majority (R. 683) and the minority (R. 695-696) cite this proposition and agree that similarity, not identity, of a given business organization with corporations constitutes the basic test.

Moreover, instantly the issue may further be narrowed, for on the face of taxpayers' own contentions the business enterprise here indisputably meets two basic corporate criteria, namely, (1) association in a common enterprise, and (2) for the purpose of carrying on a business (frequently debatable points where the issue is classification of a trust as an association). See *Morrissey* v. *Commissioner, supra,* pp. 356-361; *Bloomfield Ranch* v. *Commissioner,* 167 F. 2d 586 (C.A. 9th), certiorari denied, 335 U.S. 821; Treasury Regulations 111, Sec. 29.3797-3. Taxpayers' insistence below and the Tax Court's findings, that the limited partnership constituted a real business enterprise in

[5] The controlling holdings in these Supreme Court cases also constitute the source of essential provisions of the Treasury Regulations cited in the preceding paragraph and which, indeed, often paraphrase the language of those opinions. *United States* v. *Homecrest Tract, supra,* p. 153.

which all the limited partners were joined, also serve to satisfy at least these tests of corporate resemblance. (R. 681, 692.)

Indeed, the instant situation finds accurate description in a pertinent article by Lloyd M. Smith, entitled "Associations Classified As Corporations Under the Internal Revenue Code, 34 Calif. L. Rev. 461, 482 (1946):[6]

> It seems perfectly clear that wherever there is a sufficient community of interest to satisfy the partnership test, there is certainly enough community of interest to constitute a "joint enterprise"; and in that event, whether the organization is to be taxed as a partnership or as a corporation will depend upon whether or not the particular arrangement satisfies the third basic test of the *Morrissey* case, namely, substantial resemblance to a corporation.

3. The business enterprise, Western Construction Company, obtained, through agreement of the parties participant, the essential organizational advantages of incorporation, and accordingly the mandate of the statute requires that the income of the enterprise be taxed in the same manner as that of corporations

To adopt the language of the *Morrissey* case (p. 359):

> What, then, are the salient features of a trust [family limited partnership]—when created and maintained as a medium for the carrying on of a

[6] Mr. Smith's article has already been noticed in an opinion of this Court. *United States* v. *Homecrest Tract, supra*, p. 152, fn. 3.

> business enterprise and sharing its gains—which may be regarded as making it analogous to a corporate organization?

The Supreme Court there listed (p. 359) five such "salient features", namely (1) title in a single entity; (2) centralized management; (3) continuity; (4) transferability of beneficial interests; (5) limitation of personal liability. Accordingly, let us proceed to examine the organizational framework of taxpayer, Western Construction Company, as found by the Tax Court here upon undisputed facts, in the light of these five indicia held by the highest authority to constitute typical factors of corporate resemblance, and repeatedly employed by this Court and the several Courts of Appeals in resolving issues similar to that at bar.

(1) *Title in a single entity.* The *Morrissey* case states (p. 359):

> A corporation, as an entity, holds the title to the property embarked in the corporate undertaking.

This factor is of significance only in its practical and not in its technical aspect. By hypothesis, an "association" taxable as a corporation is not a legal entity and, hence, technical title need not be vested in it. Title in the case of a trust, for example, may be divided among the trustees and beneficiaries, and, in the case of a partnership, such as here, technically held by the parties in the forms of claims against each other, or as joint tenants or tenants in partnership, as the case may be, dependent on local law. Essentially, the test under this factor of corporate resemblance is whether the organizational form affords the advantages of capacity,

s a unit, to acquire, hold, and dispose of property, and o deal with its property separate from the property f the individual associates. Surely, taxpayer Western Construction Company satisfied this standard of corpoate resemblance for instantly there was a clear disinction between the property held by Western Contruction Company and that belonging to the individual artners. (For example, the limited partnership ertificate itself referred to "partnership property" Art. XI, R. 668) and see Sec. 9972 of the Washington tatute (10 Remington's Revised Statutes of Washington, Annotated (Appendix, *infra*)), pursuant to which he limited partnership was formed.)

Indisputably Western Construction Company was in position and indeed did acquire, hold, and dispose of he partnership property in a practical sense, separate from its members' individual property. As the Court of Appeals for the Eighth Circuit held in *Nee* v. *Main Street Bank,* 174 F. 2d 425, 432, certiorari denied, 338 U.S. 827:

> The holding of title, as an element of resemblance to a corporate undertaking, is of significance here only in its practical and not in its technical aspect. That the beneficiaries intended to vest the trustees with title is plain; the trustees furthermore held the property; and the beneficiaries took a conveyance from them when the trust was terminated.

Where the separate property of the business organization is recognized and it may deal with its property as an entity, the fact that it does not hold legal title to the property is not controlling, as this Court held in *Commissioner* v. *Fortney Oil Co.,* 125 F. 2d 995, 998.

(2) *Centralized management.* The governing Treasury Regulations 111, Section 29.3797-5, (Appendix, *infra*), provide that a limited partnership may be classified as an "ordinary partnership" or as an "association taxable as a corporation", depending upon certain "material" characteristics. Moreover, "For want of these essential characteristics, a limited partnership is to be considered as an ordinary partnership notwithstanding other characteristics conferred upon it by local law." Again, one of these "essential" characteristics is specified as "the management of its affairs * * * centralized in one or more persons acting in a representative capacity". This language is also substantially repeated by the Regulations in connection with the classification of partnerships, other than limited partnerships, as associations. See Treasury Regulations 111, Sec. 29.3797-4 (Appendix, *infra*). Certainly, in a typical common law partnership, each member is an equal manager and agent of the partnership with every other. *Poplar Bluff Printing Co.* v. *Commissioner,* 149 F. 2d 1016, 1019 (C. A. 8th). On the other hand, in limited partnerships, typically management is centralized in the general partners. In any event, instantly the limited partnership certificate explicitly provides that "The entire management of the partnership shall be vested in the three General Partners * * * " (par. X, R. 668), as against the seven limited partners in 1942 (R. 665) and the ten limited partners for the remaining tax years (R. 673).[7]

[7] To avoid unnecessary repetition record reference in this discussion will usually be made only to the first limited partnership certificate, since the terms of the second limited partnership cer-

This indicia of centralized management is also one of the features mentioned in the *Morrissey* case (p. 359) and, of course, is analogous in corporate organization to management by a board of directors.

However, in *Glensder Textile Co.* v. *Commissioner,* 46 B.T.A. 176, *supra,* upon whose authority, as already noted, the Tax Court majority here relied (R. 686-687), it was held that the limited partnership there did not satisfy the characteristic of centralized management, as follows (p. 185):

> There was centralized control by the general partners, but this fact did not make them analogous to directors of a corporation. They were acting in their own interest as hitherto, which constituted five-twelfths of the partnership, and not merely in a representative capacity for a body of persons having a limited investment and a limited liability.

On the other hand, we submit that this holding is not well founded for reasons aptly expressed by Mr. Smith in the Law Review article already cited, whose criticism we adopt, as follows (Associations Classified As Corporations Under the Internal Revenue Code, 34 Calif. L. Rev. *supra,* pp. 517-518):

> The foregoing quotation seems to confine the idea of representative management within unreasonably narrow limits. It is difficult to see why any significance should be attached to the fact that the managers of the enterprise owned an interest in the business. In many cases either the local law or the

tificate dated June 30, 1943, as found by the Tax Court (R. 673), were substantially identical with the first limited partnership certificate dated February 24, 1942. The second certificate was admitted in evidence as Petitioner's Exhibit No. 3, and is printed in full in the record (R. 231-237).

> articles of incorporation require directors to own stock in the corporation. They still operate in a manner distinctly different from democratic management by all the owners, and they act largely in a representative capacity. Many trusts have been classified as corporations although the trustees owned a substantial beneficial interest in the enterprise, and in these cases the courts had no doubt that the attribute of centralized management was present.

In the instant family association the father managers obviously acted in a representative capacity in handling their sons' and daughters' investments, which taxpayers insist the children actually subjected to the risks of the business.

Again, the *Glensder* case (p. 185) points out that there, as appears equally true here, the limited partners were not able to remove the general partners and control them in the manner in which stockholders may control directors. It is submitted that this ground is equally unsound, for even prior to the *Morrissey* case, *Hecht* v. *Malley,* 265 U.S. 144, explicitly held that an unincorporated organization may be classified as a corporation although the beneficial owners had no right to select or remove the managers. Moreover, the *Morissey* case, following *Hecht* v. *Malley, supra,* again held that control by beneficiaries, such as is commonly exercised by stockholders in a business corporation, is not essential to the existence of a taxable association. (Pp. 352-353, 358-359.) To the same effect are *Helvering* v. *Combs, supra,* p. 368; *Helvering* v. *Coleman-Gilbert supra,* pp. 372-377; and the decision of this Court in *Commissioner* v. *Vandegrift R. & Investment Co.,*

supra, p. 390. See also Treasury Regulations 111, Sec. 29.3797-3.

As a corollary, significant resemblance to action by directors does not lie in formalities of meetings or records, in seals, by-laws or minutes, or that the acts of the managers are or are not determined by majority vote. *Morrissey* v. *Commissioner, supra,* p. 358; *Helvering* v. *Coleman-Gilbert, supra,* p. 373.[8]

In summary, the significant resemblance to action by directors does not depend upon the source of the power to appoint or remove them or the formalities of meeting or records but in the circumstance that the frame of the organization secures the centralized management of its affairs through designated representatives for the conduct of the business as a joint enterprise.

(3) *Continuity.* The remaining "essential" characterisitc for a limited partnership taxable as a corporation, stated in the controlling Regulations, is expressed in the alternative as follows (Appendix, *infra*):

> Sec. 29.3797-5. * * * If the organization is not interrupted by the death of a general partner

[8] Thus, Treasury Regulations 111, Sec. 29.3797-3, making an analogous distinction between an association and a trust reads (Appendix, *infra*):

> * * * The effectiveness in action in the case of a trust or of a corporation does not depend upon technical arrangements or devices such as the appointment or election of a president, secretary, treasurer, or other "officer," the use of a "seal," the issuance of certificates to the beneficiaries, the holding of meetings by managers or beneficiaries, the use of a "charter" or "by-laws," the existence of "control" by the beneficiaries over the affairs of the organization, or upon other minor elements. They serve to emphasize the fact that an organization possessing them should be treated as a corporation, but they are not essential to such classification, for the fundamental benefits enjoyed by a corporation, as outlined above, are attained, in the case of a trust, by the use of the trust form itself.

> *or* by a change in the ownership of his participating interest, * * * it is taxable as a corporation. (Italics supplied.)

Instantly, the organization, Western Construction Company, clearly satisfies this requirement.

Indeed, the Tax Court explicitly found that the limited partnership was the result of years of thought by the general partners directed to the end that the business would continue uninterrupted by the death or retirement of the general partners. Thus, the Tax Court found as follows (R. 676):

> The limited partnership was not the result of an impulse set off by the desire to minimize taxes, but rather the result of many years of thought by the general partners who were anxious to have their sons, daughters, and sons-in-law come into the business so that *it would continue after the general partners retired or died.* (Italics supplied.)

At the time of the formation of the limited partnership, the ages of the general partners were: J. A. Johnson, 64; George Johnson, 62; Albin Johnson, 52. (R. 219.) Typical in support of the quoted Tax Court finding is the testimony of J. A. Johnson on direct examination (R. 219):

> Q. Did or did not Roy Johnson's going with Kuney have any part in your intentions to form this limited partnership?
>
> A. Well, we formed the limited partnership with the intention that we would be able to keep these boys with us and continue the business. We realized, both George and myself, that we were getting pretty well up in age and we were in hopes that our

families could stick together and keep on the business.

Again, the testimony of two of the limited partners, Roy Johnson, son of J. A. Johnson (R. 416-417), and Winston Johnson, son of the general partner, Albin Johnson (R. 447-448), both on direct examination, for example, confirmed this purpose, in organizing the limited partnership, of building up a permanent family association. Thus, at the hearing, which it is noted, was had in 1948, Roy Johnson said "we could build a larger *company* and carry forward to larger projects" (italics supplied) (R. 417), and Winston Johnson was even more explicit (R. 448):

> I have always dreamed of the Western Construction Company being probably one of the largest construction *companies* in the Northwest, and we have always done large work, and we have gotten a good name for ourselves, and *I could not see why we could not continue this,* the three boys with the help from their sisters and the husbands of their sisters, and even though those husbands, like Mr. Ellingson, worked for us as a foreman, even in that capacity the fact that he was in the family and had an interest in the *company,* would be better for him and better for the *company* than other men that just were working for wages and had no other interest. And I still foresee in the future that the three boys and myself and the rest of us are going to continue in this type of work, and I still have got ambitions about this *company* becoming something again. (Italics supplied.)

The limited partnership certificate signed by all of the parties was carefully framed to carry out this long

cherished design of assuring the organizational advantage similar to that possessed by corporations, that the business "would continue after the general partners retired or died." (R. 676.) Thus, an absolute term for ten years was provided during which "the partnership shall exist". (Par. V, R. 667); (par. VII, R. 667.) Under the controlling Washington statute (10 Remington's Revised Statutes of Washington, Annotated, Sec. 9974, Appendix, *infra*), these provisions inhibited dissolution of the partnership upon, for example, retirement of a general partner, without the written consent of all of the general and limited partners in a notice of such dissolution, subscribed by all of them, filed with the original certificate and published in the same manner and for the time prescribed for the publication of the original certificate.[9] The similarity of this procedure for dissolution of the association by certificate filed and published publicly to the procedure commonly prescribed for voluntary dissolution of corporations is obvious.

Moreover, the identical paragraph (X) of the limited partnership certificate which, as already discussed, vested the "entire management" of the partnership in the three general partners, further provided (R. 668):

> the right is hereby given to the remaining General Partners to continue the business upon the death or retirement of a General Partner, and the right is also given to the General Partners to continue the business upon the death or retirement of any of the Limited Partners hereto.

[9] Namely, for four consecutive weeks. Secs. 9968 and 9969 of the Washington statute. (Appendix, *infra*.)

Whether or not technically upon the death or retirement of a general partner, a new partnership would arise and the old partnership dissolve seems unimportant and only a matter of metaphysics in the present context. Under this certificate the right is given for the business to continue, i.e., an organization is created which, like a corporation, need not be interrupted, wound up, or liquidated upon the death or retirement of either a general or a limited partner.

Moreover, the power to continue the business after the death or retirement of a general partner, which the right expressed in paragraph X of the agreement conferred, was in clear implementation of the basic purpose of the general partners to that end, which, as already seen, the Tax Court found as the fact. (R. 676.) Indeed, to carry out this fundamental design, such a specific agreement was necessary to prevent dissolution upon the death or retirement of either a general or a limited partner. *Ames* v. *Downing,* 1 Bradford 321, 325-333 (N.Y.); 2 Rowley, Modern Law of Partnership, Sec. 1035, p. 1411 (1916). Similarly, under the Uniform Limited Partnership Act, enacted in 1945 in Washington though not applicable to taxpayer during the taxable years (Remington's Revised Statutes of Washington, Annotated, (1945 Supp.), Sec. 9975-30 (2)), a general partner has no authority to continue the business with partnership property on the death or retirement of another general partner, unless the right so to do is expressly given in the limited partnership certificate. Sec. 9975-9 (1) (g) and Sec. 9975-20. Thus, the rule under the controlling Washington statutes is

clearly the same as that stated in the Regulations, with respect to limited partnerships organized under the Uniform Limited Partnership Act, namely, here as under the Uniform Act (Sec. 29.3797-5):

> A limited partnership * * * may be either an association or a partnership depending upon whether or not in the particular case the essential characteristics of an association exist.

The deliberate moulding of the organizational frame of the instant enterprise assured the existence in this "particular case" of "the essential characteristics of an association", as specified in the cited Regulations and the other authorities.

Contractual arrangements are not uncommon under which surviving partners continue an enterprise without liquidation, operating it for the benefit of themselves and the decedent's beneficiaries. The property of the deceased member remains subject to the risks of the business, but limited to the decedent's interest in the business as it existed at the time of his death. Such an arrangement is particularly appropriate in the case of a family partnership, where the deceased brother might be expected to possess confidence in the ability and integrity of the surviving general partner brothers, and where the beneficiaries of the deceased estate would in all likelihood be identical with some of the limited partners, namely, his children. Cases illustrating such agreements are *Stearns* v. *Brookline,* 219 Mass. 238; *Wild* v. *Davenport,* 48 N.J.L. 129; *Brew* v. *Hastings,* 196 Pa. 222; dicta in *Scholefield* v. *Eichelberger,* 7 Pet. 586, 594; *Burwell* v. *Mandeville's Executor,* 2 How. 559,

576. For a careful exposition, analysis and statement of the binding effect of such agreements, citing precedents, see Warner Fuller, Partnership Agreements for Continuation Of An Enterprise After the Death Of A Partner, 50 Yale L.J. 202, 204, 211 (1940).[10]

There is no reason to suppose that the law of Washington differs although direct authority is lacking. Cf. *In re Randle's Estate,* 29 Wash. 2d 447, 456-457, 188 P. 2d 71, which approved an agreement enabling a partnership to continue and affording the surviving partner the right to purchase the interest of a deceased partner at a fixed or determinable price.

The continuity of an organization without interruption by death is insured when the terms of the enterprise are binding upon an investor's successors, heirs, representatives, and assigns. *Bloomfield Ranch* v. *Commissioner, supra,* p. 592. In *Wabash Oil & Gas Ass'n* v. *Commissioner, supra,* p. 660, an association formed to operate an oil and gas lease was to continue during the term of the lease and it was provided that no party was entitled to dissolution but on the death or bankruptcy of any one, his personal representative or trustee in bankruptcy should succeed to his interest. See

[10] In a footnote the author of the cited article suggested that, whether arrangements of this type in a given case result in an "association", "presents an important tax problem." (P. 204, n. 10.) Without discussion he briefly indicated his view that this tax question had not then been decided, but that it seemed to have been assumed that a partnership exists where the members operate their business along orthodox lines and further, even if the arrangement is regarded as an association, appreciable tax savings (other than federal income tax) can be afforded through elimination of formal incorporation. Only pre-*Morrissey* authorities were referred to; the *Morrissey* case and the controlling Regulations were apparently not considered.

also *Poplar Bluff Printing Co.* v. *Commissioner, supra,* p. 1019.

Taxpayers may argue that paragraph X of the certificate merely affords the surviving partners the right to continue the business upon partial liquidation, namely, upon paying off the interest of a deceased partner, as in *In re Randle's Estate, supra,* which, here in the case of a deceased general partner, might amount to one-sixth. However, similar arrangements are not uncommon in the case of closed corporations upon the decease of a stockholder, and do not involve termination of the business, but only decrease in the capital. Further, the power conferred under paragraph X of the certificate need not be construed to be so limited, but, on the contrary, to comprehend the broader type of continuing arrangement, entailing no liquidation, as described above.

In any event, the proposition is well established that, for the purpose of determining whether an organization constitutes an association, where parties operate under an instrument their relationship is governed by the powers conferred by the instrument rather than by what the parties may have thought or even have done. *Wholesalers Adjustment Co.* v. *Commissioner,* 88 F. 2d 156, 157 (C.A. 8th).

Thus, recently, in *United States* v. *Homecrest Tract, supra,* p. 152, this Court held, citing and following the *Morrissey* case, as follows:

> The test is whether the trust deed discloses an association of individuals for the purpose of carrying on a business. This is to be determined from

> the trust instrument itself—from what *could be done* under the trust and *not from what is done.*

The character of an association is determined not by the extent to which the powers in the fundamental instrument organizing it have actually been exercised, but rather by the purposes and potentialities disclosed by that instrument on its face. *Morrissey* v. *Commissioner, supra,* pp. 360-361. It cannot escape taxation by declining to exercise powers which the instrument of its creation permits. *Helvering* v. *Coleman-Gilbert, supra,* pp. 373-374; *Commissioner* v. *Vandegrift R. & Inv. Co., supra,* p. 390; *Bert* v. *Helvering,* 92 F. 2d 491, 493 (C.A. D.C.); *Sears* v. *Hassett,* 111 F. 2d 961, 962-963 (C. A. 1st); *Second Carey Trust* v. *Helvering,* 126 F. 2d 526, 528 (C.A. D.C.), certiorari denied, 317 U.S. 642; *Porter* v. *Commissioner,* 130 F. 2d 276, 280 (C.A. 10th); *Pennsylvania Co. for Insurances, Etc.* v. *United States,* 138 F. 2d 869, 974 (C.A. 3d), certiorari denied, 321 U.S. 788; *Commissioner* v. *City Nat. Bank & T. Co.,* 142 F. 2d 771, 775 (C.A. 10th), certiorari denied, 323 U.S. 764; *Nee* v. *Main Street Bank,* 174 F. 2d 425, 429 (C.A. 8th).

We submit the Tax Court minority was here correct in pointing out that in *Glensder Textile Co.* v. *Commissioner, supra,* decided in 1942 prior to the Supreme Court decisions in *Commissioner* v. *Tower,* 327 U.S. 280, and *Lusthaus* v. *Commissioner,* 327 U.S. 293, the Board of Tax Appeals (R. 693-694)—

> was not confronted by the juxtaposition of a developed family partnership rule with the similarity of limited family partnerships to corpora-

> tions, and hence it cannot be regarded as controlling this question. It is for that reason, at least, less persuasive than a more recent decision of this Court holding certain family limited partnerships to be taxable as corporations. *Giant Auto Parts, Ltd.,* 13 T.C. 307.

Instantly, by agreement the parties here obtained the advantages of corporate similarity, which the Ohio statute in the cited case of *Giant Auto Parts* v. *Commissioner,* 13 T.C. 307, afforded the family limited partnership association there involved.

As already seen, the instant certificate provides that the partnership is to exist for ten years. (Par. V, VII, R. 667.) Cf. *Helm & Smith Syndicate* v. *Commissioner, supra,* p. 441, where although a single beneficiary might revoke a trust, each beneficiary had agreed to twenty-five years continuance. A trust frequently is provided to continue during the life of named persons or until the death of the last surviving trustee or settler. See *Commissioner* v. *Vandegrift R. & Inv. Co.,* 82 F. 2d 387, 389 (C.A. 9th); *Reynolds* v. *Hill,* 184 F. 2d 294 (C.A. 8th). Thus, even though all three general partners should die prior to the expiration of its ten year period, still reasonable continuity of the business is guaranteed for that period, amounting to three lives in being or ten years, and similar to the duration defined in business trust cases.

(4) *Transferability of beneficial interest.* By the agreement of the parties set forth in the limited partnership certificate large transferability of partnership interest was obtained in this business enterprise sub-

tantially similar to that commonly obtained in close family corporations. Thus, here, under paragraph XII of the certificate, it was provided (R. 668-669):

> The interests of all the Limited Partners herein may be transferred upon the approval of the General Partners to accept a new assignee as a Limited Partner in this co-partnership, and not otherwise.

In addition, pursuant to paragraph IX (R. 668):

> The General Partners are hereby given the right to admit additional Limited Partners in the future upon the agreement of the General Partners hereto, but in no event other than upon a cash contribution to the partnership, and upon the same terms as herein expressed.

Again, the provisions of the partnership certificate had the further effect of enabling the associates to avoid winding up and to continue the business even despite transfer of his interest by a general partner. This was a further consequence of paragraph X (R. 668) discussed, *supra,* since paragraph X empowered the remaining general partners to continue the business upon the retirement of a general partner and the attempt by a general partner to transfer his interest would effect his retirement as a general partner.

In this connection, Mr. Smith, in Associations Classified as Corporations, 34 Calif. L. Rev., *supra,* p. 533, states:

> Reasonable restrictions on the transfer of corporate stock are both lawful and common, but it seems that any absolute prohibition against all transfers of stock would be void as against public

> policy, at least under all normal conditions. This requires the conclusion that reasonable restrictions on the transfers of beneficial interests in an unincorporated enterprise are not very important; but it would not be unreasonable to hold that a "spendthrift trust", which contains an absolute and inescapable prohibition against transfers of beneficial interests, is so unlike both the law and the practice of corporations that it should not be classified as a corporation for purposes of taxation.

In *Wholesalers Adjustment Co.* v. *Commissioner,* 88 F. 2d 156, *supra,* p. 157, an unincorporated organization was held taxable as a corporation where the beneficial interest could not be transferred unless the managing partner consented. In *Pennsylvania Co. for Insurances, Etc.* v. *United States, supra,* p. 873, the beneficiaries of the trust might assign their interest, but the assignees must be approved by the trustee. (Cf. paragraph XII of the instant certificate.) See also *Wabash Oil & Gas Ass'n* v. *Commissioner, supra,* where although a subscriber might sell his interest, it was provided that he first must give the managing agents an opportunity to buy the interest for the benefit of the other subscribers.

Certainly here in view of the clear design to perpetuate this close family business within the family after the general partners retired or died (R. 676), reasonable transferability was provided substantially identical to that frequently obtaining in formally incorporated close family businesses. Accordingly on this factor, too, the instant organization satisfied the corporate resemblance test. Returning once more to the

est provided in the alternative by the governing Treasury Regulations (Sec. 29.3797-5), as a matter of law, he instant "organization is not interrupted by the eath of a general partner *or* by a change in the ownership of his participating interest". (Italics supplied.)

(5) *Limitation of Personal Liability.* The liability f the special partners is here, of course, limited to the mount of their investment, as in the case of stockolders. The liability of the general partners is unimited. However, it has frequently been held that comlete limitation of liability is not an indispensable haracteristic for corporate resemblance. So this Court eld in *Helm & Smith Syndicate* v. *Commissioner, upra,* p. 441, as follows:

> Petitioner claims and respondent denies that the liability of each beneficiary is that in a partnership. Even if so, limitation of the beneficiary's liability is not a *sine qua non* of the corporate analogy.

To the same effect are *Bert* v. *Helvering, supra,* p. 495; *Poplar Bluff Printing Co.* v. *Commissioner, supra,* p. 019; *Nee* v. *Main Street Bank, supra,* p. 432, and Section 29.3797-4 (Appendix, *infra*) of the controlling Treasury Regulations.

In summary, the combined attributes of corporate esemblance here present clearly support the conclusion f the minority opinion below, as follows (R. 695-696):

> In fact, if the general partners are thought of as common stockholders, and the special partners as holders of participating preferred stock, the entire arrangement would be identical in all respects with a corporate structure, except for the

> unlimited liability of the general partners. Since it is similarity and not identity which constitutes the test, *Morrissey* v. *Commissioner,* and since it is the interest of the special partners, and not that of the general partners, which raises the real present issue on both alternative contentions, it seems to me inescapable that this arrangement fails on the one hand to bear any resemblance to a true and actual partnership of all the participants, see Hill, Judge, dissenting in John A. Morris, 13 T.C. . . . (Dec. 21, 1949), but that on the other, it does resemble and almost duplicates a corporation, and that reality thus requires the tax to be imposed upon it as a corporation and not as a partnership.

D. *Special provisions of Washington law add to the corporate likeness of Western Construction Company*

In *State Ex Rel. Range* v. *Hinkle,* 126 Wash. 581, 219 Pac. 41, the Supreme Court of Washington quoting the state constitution, expressed the issue there before it as follows (p. 583):

> Section 5, of art. 12, of the state constitution, relating to corporations other than municipal, provides:
>
> "The term 'corporation' as used in this article, shall be construed to include all associations and joint stock companies having any powers or privileges of corporations not possessed by individuals or partnerships, and all corporations shall have the right to sue and shall be subject to be sued in all courts in like cases as natural persons."
>
> The question then arises whether or not this common law trust is an "association having powers

and privileges of corporations not possessed by individuals and partnerships."

The court, answering the question thus posed in the affirmative, said (p. 584):

> Under constitutional provisions similar to § 5, art. 12, *supra,* it is almost uniformly held that joint stock companies and limited partnerships organized under statutory authority are in fact corporations.

Moreover, instantly the minority opinion below points out that the nomenclature employed in the statute, under whose authority the instant limited partnership was organized, resembles and is appropriate for corporate organization. (R. 695.) Thus, the Washington statute under which taxpayer "company" was formed, repeatedly refers to the capital of the enterprise as common stock" and "capital stock". 10 Remington's Revised Statutes of Washington, Annotated, Sections 9967, 9968, 9972, 9973. (Appendix, *infra.*) Again, similar to the almost universal corporate provision, this statute prescribes that (Sec. 9972):

> * * * no part of the capital stock thereof shall be withdrawn, nor any division of interests be made, so as to reduce such capital stock below the sum stated in the certificate of partnership before mentioned; and if at any time during the continuance or at the termination of such partnership, the property or assets thereof are not sufficient to satisfy the partnership debts, then the special partners shall be severally liable for all sums or amounts by them in any way received or with-

> drawn from such capital stock, with interest thereon from the time they were so received or withdrawn respectively.

Also resembling common corporate provision is the prescription of Section 9968 that the basic certificate shall contain "the amount of capital which each special partner has contributed to the common stock".

While, as the minority opinion below also points out (R. 695), this statutory nomenclature is not decisive, nevertheless, it adds further support to the Commissioner's contention that this business enterprise closely resembles and has obtained the organizational advantages of incorporation, and should, therefore, be classified as an association and placed in the same tax category as corporate organizations of essentially the same character, regardless of formal technicality.

III

Alternatively, Western Construction Company Fails to Bear any Resemblance to an Actual Partnership of Which the Limited Partners Were Component Members

As already discussed in Point 1, *supra,* the instant Point III is presented in the alternative. Thus, in the event the Court holds in accord with the Commissioner's contention that Western Construction Company is taxable as a corporation (Point II, *supra*), the instant Point III is not reached for consideration.

The Commissioner's position, in accord with that expressed by the minority opinion below, is that, as already noted (Point I, *supra*), the issue of the reality of the limited partnership and the resemblance of the enterprise to a corporation cannot be neatly severed.

(R. 693.) Thus, if the limited partners (resembling preferred stockholders) are not associated with the general partners (resembling common stockholders) in an enterprise taxable as a corporation, then the so-called limited partners are not actual participants in the business at all. (R. 696.) Their role is then merely that of partial assignees of their respective fathers' income and the so-called limited partnership is taxwise —so far as the children are concerned—merely an arrangement for anticipatory assignment of income. Under the rule of the *Tower* and *Lusthaus* cases, *supra,* and of *Commissioner* v. *Culbertson,* 337 U.S. 733, the fathers' income thus anticipatorily assigned to the children is taxable to the respective assignor fathers.

In the *Tower* case a purported family limited partnership also was involved. The Supreme Court said (pp. 290-292):

> It is the command of the taxpayer over the income which is the concern of the tax laws. *Harrison* v. *Schaffner,* 312 U.S. 579, 581, 582. And income earned by one person is taxable as his, if given to another for the donor's satisfaction. *Helvering* v. *Horst,* 311 U.S. 112, 119. It is for this reason, among others, that we said in *Helvering* v. *Clifford, supra,* 335, that transactions between husband and wife calculated to reduce family taxes should always be subjected to special scrutiny. For if under circumstances such as those now before us, the end result of the creation of a husband-wife partnership, though valid under state laws, is that income produced by the husband's efforts continues to be used for the same business and family purposes as before the partnership, failure to tax it as the

> husband's income would frustrate the purpose of 26 U.S.C. § 22 (a). By the simple expedient of drawing up papers, single tax earnings cannot be divided into two tax units and surtaxes cannot be thus avoided.
>
> * * * * *
>
> The wife again took no part in the management or operation of the business. If it be said that as a limited partner she could not share in the management without becoming a general partner the result is the same. No capital not available for use in the business before was brought into the business as a result of the formation of the partnership. And the wife drew on income which the partnership books attributed to her only for purposes of buying and paying for the type of things she had bought for herself, home and family before the partnership was formed.

True, a finding of the Tax Court on the reality of a partnership is essentially a fact finding (*Commissioner* v. *Culbertson, supra,* pp. 741-742), subject to the "clearly erroneous" rule. However, as recently expressed by the Court of Appeals for the Tenth Circuit in *Maytag* v. *Commissioner,* decided March 21, 1951 (C.C.H., Federal Estate and Gift Tax Reporter, par. 10,800)—

> [a Tax Court] finding must be treated as clearly erroneous if based upon substantial error in the proceeding, if unsupported by any substantial evidence, if contrary to the clear weight of all the evidence, or if supported by evidence but the court of appeals in reviewing the entire evidence entertains the definite and firm conviction that a mistake has been committed.

Instantly, the underlying facts are not in contest, and if the relationship of the so-called limited partners to the enterprise is not as a consequence of its undisputed organizational form taxwise, as a matter of law under the statute, Regulations and authorities, that of stockholders to a corporation, then the finding of the Tax Court majority that the parties formed a bona fide partnership and really and truly intended to join together for the purpose of carrying on a partnership business (R. 681) is clearly erroneous as unsupported by any substantial evidence, as contrary to the clear weight of all the evidence, or if regarded as having support in the evidence, then on review by this Court of the entire evidence it is clear the fact finder was mistaken.

The record is replete with indicia that the parties did not intend to join together with a business purpose in the conduct of a partnership. The Tax Court found that the daughters did not render any services to the limited partnership of any substantial consequence (R. 678), and while the sons contributed engineering skill, which the general partners lacked, of substantial value to the partnership (R. 691), such services, as they did perform, were in part at odd hours and in addition to regular employment elsewhere (R. 676-678), and were under the direction of the general partners (R. 681). On the whole there was no change in the operation or management of the business after the formation of the limited partnership (R. 680-681), which, as before, remained under the direction of the three fathers.

Furthermore, the limited partners made their cash contributions to the partnership with money they borrowed from their respective fathers. The fathers drew checks on moneys they had to their credit on the books of Western Construction Company and delivered these checks to their children and in return each child gave his or her promissory note payable to the father. Each limited partner then gave the limited partnership a check in the amount of the loan in payment of his or her limited partnership interest.[11] Thus the partnership itself did not by this transaction increase its assets. The only net result was that each of the general partners had in his possession $20,000 worth of notes signed by his children.

The conclusion of the Tax Court that the possession of these notes was a factor of considerable importance to the financial status of the general partners and through them to the limited partnership, seems clearly erroneous (R. 689-690), in view, among others, of the undisputed finding that the notes were never pledged as collateral for any loan, but were merely listed as personal assets of the general partners in application for construction bonds (R. 671). Indeed, J. A. Johnson, one of the general partners, on cross examination could not even remember whether the bonding company

[11] When the three additional daughters were brought in as purported limited partners in 1943, none of the new partners made a direct or additional contribution of capital to the partnership. The new parties merely obtained a division of the interest which had been held in the name of brothers or sisters, who already were limited partners. This was accomplished by the unpaid notes of the latter partners being returned to them by their fathers and new notes being given aggregating the same amount as the original notes. (R. 674-675.)

ever looked at the notes. (R. 251.) The notes were all for short terms not exceeding two years, except in two cases when they were payable in yearly instalments of not less than $3,500 in any one payment. (R. 675.) Nevertheless, they appeared not to have been paid when due. Some were paid in 1945, one in 1946, two in 1947, and one had not been paid at the time of the hearing in 1948, despite the credit of large partnership profits to the children.

All the foregoing factors indicate that the so-called partnership contribution lacked economic reality and did not constitute substantial evidence of real intent to join in a partnership venture.

That the addition of the $60,000 in notes to the individual assets of the general partners was actually not a factor of considerable importance to their financial status, that the Tax Court was clearly erroneous in so finding, and that the net transaction between the fathers and the children amounted to nothing more than the drawing up of papers, is further evidenced by the circumstance that at the time the limited partnership was created Western Construction Company had well under way two large government contracts upon which gross profits were reflected in the first year of the limited partnership in amounts exceeding in the aggregate $436,000, which resulted in the crediting of profits to each partner including the limited partners of more than three and a half times his capital account. (R. 260, 604-607, 675-676.) George Johnson, one of the general partners, testified at the time the limited partnership was created in February, 1942, 40% of the Quartermaster contract upon which over $234,800 gross profit

was eventually realized, had already been completed, and the Rainier Vista contract, upon which eventually nearly $202,000 gross profit was realized, was between 25% and 30% completed. (R. 604-607.) The total cost of each of these contracts was eventually between a million and a quarter dollars and a million and a half dollars. (R. 606-607.) In view of the foregoing, it seems clear error for the Tax Court to have found that the $60,000 credit, which the children contributed in this unusual and circuitous manner, was of any substantial importance to the financial status of the business or of the general partners.

Additionally, in view of the pending profits on the partially completed government contracts, the granting of a one half share in the whole enterprise in return for the children's notes given under the circumstances above described, surely lacked business reality as a genuine partnership proposition.[12]

Finally, while some of the limited partners withdrew their shares of the profits, the majority actually did not withdraw a great deal of their profits, as the Tax Court found. (R. 690-691.) Besides, substantial amounts of the withdrawals appear to have been used merely to pay federal income taxes on the profits (which otherwise would have been payable by the general partners at higher surtax rates). See Resp. Ex. H. (R. 591-596.)

For similar reasons limited partnerships were not recognized for tax purposes in *Stanback* v. *Robertson,*

[12] The partnership profits credited to each child are set forth in the statements .(Pet. Exs. 12 (R. 379); 15 (R. 429); 16 (R. 460); 20 (R. 494); 21 (R. 522); 22 (R. 529); 23 (R. 539); 26 (R. 563); 27 (R. 565); 28 (R. 567).

183 F. 2d 889 (C.A. 4th), certiorari denied, 340 U.S. 904; and in the clear opinion of Judge Yankwich in *Toor* v. *Westover,* 94 F. Supp. 860 (S.D. Calif.), where the principles governing the instant issue are stated and applied. Cf., on the other hand, *Lamb* v. *Smith,* 183 F. 2d 938 (C.A. 3d), in which a jury verdict, sustaining a limited partnership, was under scrutiny and, hence, the scope of review was more limited than here, where the fact finding may be set aside for clear error.

CONCLUSION

For the reasons above given, the decisions of the Tax Court are erroneous and should be reversed.

Respectfully submitted,

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MAY, 1951.

Internal Revenue Code:

SEC. 3797. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

(1) *Person.*—The term "person" shall be construed to mean and include an individual, a trust, estate, partnership, company, or corporation.

(2) *Partnership and Partner.*—The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

(3) *Corporation.*—The term "corporation" includes associations, joint-stock companies, and insurance companies.

(26 U.S.C. 1946 ed., Sec. 3797.)

10 Remington's Revised Statutes of Washington, Annotated:

CHAPTER 1

LIMITED PARTNERSHIPS

§ 9966. *Limited partnership may be formed.* Limited partnership for the transaction of mercantile, mechanical, or manufacturing business may be formed within this state, by two or more persons, upon the terms and subject to the conditions contained in this chapter.

§ 9967. *Of whom composed, and liability of members.* A limited partnership may consist of two or more persons, who are known and called general partners, and are jointly liable as general partners now are by law, and of two or more persons who shall contribute to the common stock a specific sum in actual money as capital, and are known and called special partners, and are not personally liable for any of the debts of the partnership, except as in this chapter specially provided.

§ 9968. *Certificate to be made, acknowledged and filed.* The persons forming such partnership shall make and severally subscribe a certificate, in duplicate, and file one of such certificates with the county auditor of the county in which the principal place of business of the partnership is to be. Before being filed, the execution of such certificate shall be acknowledged by each partner subscribing it, before some officer authorized to take acknowledgments of deeds, and such certificate shall contain the name assumed by the partnership and under which its business is to be conducted, the names and respective places of residence of all the general and special partners, the amount of capital which each special partner has contributed to the common stock, the general nature of the business to be transacted, and the time when the partnership is to commence, and when it is to terminate.

§ 9969. *False Statement—Publication of copy.*. Such partnership cannot commence before the filing of the certificate of partnership, and if a false statement is made in such certificate, all the persons subscribing thereto are liable as general partners for all the debts of the partnership. The partners shall, for four consecutive weeks immediately after the filing of the certificate of partnership, publish a copy of the same in some weekly newspaper, published in the county where the principal place of business of the partnership is, or if

no such paper be published therein, then in some newspaper in general circulation therein, and until such publication is made and completed, the partnership is to be deemed general.

§ 9970. *Renewal of limited partnership.* A limited partnership may be continued or renewed by making, acknowledging, filing, and publishing a certificate thereof, in the manner provided in this chapter for the formation of such partnership originally, and every such partnership, not renewed or continued as herein provided, from and after the expiration thereof according to the original certificate, shall be a general partnership.

§ 9971. *Name of firm—When special liable as general partner.* The business of the partnership may be conducted under a name in which the names of the general partners only shall be inserted, without the addition of the word "company" or any other general term. If the name of any special partner is used in such firm with his consent or privately, he shall be deemed and treated as a general partner, or if he personally makes any contract, respecting the concerns of the partnership, with any person except the general partners, he shall be deemed and treated as a general partner in relation to such contract, unless he makes it appear that in making such contract he acted and was recognized as a special partner only.

§ 9972. *Withdrawal of stock and profits—Effect of.* During the continuance of any partnership formed under this chapter no part of the capital stock thereof shall be withdrawn, nor any division of interests be made, so as to reduce such capital stock below the sum stated in the certificate of partnership before mentioned; and if at any time during the continuance or at the termination of such partnership, the property or assets thereof are not sufficient to satisfy the part-

nership debts, then the special partners shall be severally liable for all sums or amounts by them in any way received or withdrawn from such capital stock, with interest thereon from the time they were so received or withdrawn respectively.

§ 9973. *Suits by and against limited partnership—Parties.* All actions, suits, or proceedings respecting the business of such partnership shall be prosecuted by and against the general partners only, except in those cases where special partners or partnerships are to be deemed general partners or partnerships, in which case all the partners deemed general partners may join therein; and excepting also those cases where special partners are severally liable on account of sums or amounts received or withdrawn from the capital stock, as provided in the last preceding section.

§ 9974. *Dissolution, how may be accomplished.* No dissolution of a limited partnership shall take place, except by operation of law, before the time specified in the certificate of partnership, unless a notice of such dissolution, subscribed by the general and special partners, is filed with the original certificate of partnership, or the certificate, if any, renewing or continuing such partnership, nor unless a copy of such notice be published for the time and in the manner prescribed for the publication of the certificate of partnership.

§ 9975. *Liabilities and rights of members of firm.* In all cases not otherwise provided for in this chapter, all the members of limited partnerships shall be subject to all the liabilities and entitled to all the rights of general partners.

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.3797-1. *Classification of Taxables.*—For the purpose of taxation the Internal Revenue Code makes

its own classification and prescribes its own standards of classification. Local law is of no importance in this connection. Thus, a trust may be classed as a trust or as an association (and, therefore, as a corporation), depending upon its nature or its activities. (See section 29.3797-3.) The term "partnership" is not limited to the common law meaning of partnership, but is broader in its scope and includes groups not commonly called partnerships. (See section 29.3797-4.) The term "corporation" is not limited to the artificial entity usually known as a corporation, but includes also an association, a trust classed as an association because of its nature or its activities, a joint-stock company, an insurance company, and certain kinds of partnerships. (See sections 29.3797-2 and 29.3797-4.) The definitions, terms, and classifications, as set forth in section 3797, shall have the same respective meaning and scope in these regulations.

SEC. 29.3797-2. *Association.*—The term "association" is not used in the Internal Revenue Code in any narrow or technical sense. It includes any organization, created for the transaction of designated affairs, or the attainment of some object, which, like a corporation, continues notwithstanding that its members or participants change, and the affairs of which, like corporate affairs, are conducted by a single individual, a committee, a board, or some other group, acting in a representative capacity. It is immaterial whether such organization is created by an agreement, a declaration of trust, a statute, or otherwise. It includes a voluntary association, a joint-stock association or company, a "business" trust, a "Massachusetts" trust, a "common law" trust, an "investment" trust (whether of the fixed or the management type), an interinsurance exchange operating through an attorney in fact, a partnership association, and any other type of organization (by

whatever name known) which is not, within the meaning of the Code, a trust or an estate, or a partnership. If the conduct of the affairs of a corporation continues after the expiration of its charter, or the termination of its existence, it becomes an association.

SEC. 29.3797-3. *Association Distinguished from Trust.*—The term "trust," as used in the Internal Revenue Code, refers to an ordinary trust, namely, one created by will or by declaration of the trustees or the grantor, the trustees of which take title to the property for the purpose of protecting or conserving it as customarily required under the ordinary rules applied in chancery and probate courts. The beneficiaries of such a trust generally do no more than accept the benefits thereof and are not the voluntary planners or creators of the trust arrangement. Even though the beneficiaries do create such a trust, it is ordinarily done to conserve the trust property without undertaking any activity not strictly necessary to the attainment of that object.

As distinguished from the ordinary trust described in the preceding paragraph there is an arrangement whereby the legal title to the property is conveyed to trustees (or a trustee) who, under a declaration or agreement of trust, hold and manage the property with a view to income or profit for the benefit of beneficiaries. Such an arrangement is designed (whether expressly or otherwise) to afford a medium whereby an income or profit-seeking activity may be carried on through a substitute for an organization such as a voluntary association or a joint-stock company or a corporation, thus obtaining the advantages of those forms of organization without their disadvantages. The nature and purpose of a cooperative undertaking will differentiate it from an ordinary trust. The purpose will not be considered narrower than that which is formally set forth in the

instrument under which the activities of the trust are conducted.

If a trust is an undertaking or arrangement conducted for income or profit, the capital or property of the trust being supplied by the beneficiaries, and if the trustees or other designated persons are, in effect, the managers of the undertaking or arrangement, whether the beneficiaries do or do not appoint or control them, the beneficiaries are to be treated as voluntarily joining or cooperating with each other in the trust, just as do members of an association, and the undertaking or arrangement is deemed to be an association classified by the Internal Revenue Code as a corporation. However, the fact that the capital or property of the trust is not supplied by the beneficiaries is not sufficient reason in itself for classifying the arrangement as an ordinary trust rather than as an association.

By means of such a trust the disadvantages of an ordinary partnership are avoided, and the trust form affords the advantages of unity of management and continuity of existence which are characteristic of both associations and corporations. This trust form also affords the advantages of capacity, as a unit, to acquire, hold, and dispose of property and the ability to sue and be sued by strangers or members, which are characteristic of a corporation; and also frequently affords the limitation of liability and other advantages characteristic of a corporation. These advantages which the trust form provides are frequently referred to as resemblance to the general form, mode of procedure, or effectiveness in action, of an association or a corporation, or as "quasi-corporate form." The effectiveness in action in the case of a trust or of a corporation does not depend upon technical arrangements or devices such as the appointment or election of a president, secretary, treasurer, or other "officer," the use of a "seal,"

the issuance of certificates to the beneficiaries, the holding of meetings by managers or beneficiaries, the use of a "charter" or "by-laws," the existence of "control" by the beneficiaries over the affairs of the organization, or upon other minor elements. They serve to emphasize the fact that an organization possessing them should be treated as a corporation, but they are not essential to such classification, for the fundamental benefits enjoyed by a corporation, as outlined above, are attained, in the case of a trust, by the use of the trust form itself. The Internal Revenue Code disregards the technical distinction between a trust agreement (or declaration) and ordinary articles of association or a corporate charter, and all other differences of detail. It treats such a trust according to its essential nature, namely as an association. This is true whether the beneficiaries form the trust or, by purchase or otherwise, acquire an interest in an existing trust.

The mere size or amount of capital invested in the trust is of no importance. Sometimes the activity of the trust is a small venture or enterprise, such as the division and sale of a parcel of land, the erection of a building, or the care and rental of an office building or apartment house; sometimes the activity is a trade or business on a much larger scale. The distinction is that between the activity or purpose for which an ordinary strict trust of the traditional type would be created, and the activity or purpose for which a corporation for profit might have been formed.

SEC. 29.3797-4. *Partnerships.*—The Internal Revenue Code provides its own concept of a partnership. Under the term "partnership" it includes not only a partnership as known at common law, but, as well, a syndicate, group, pool, joint venture, or other unincorporated organization which carries on any business, financial operation, or venture, and which is not, within

the meaning of the Code, a trust, estate, or a corporation. On the other hand the Code classifies under the term "corporation" an association or joint-stock company, the members of which may be subject to the personal liability of partners. If an organization is not interrupted by the death of a member or by a change in ownership of a participating interest during the agreed period of its existence, and its management is centralized in one or more persons in their representative capacities, such an organization is an association, taxable as a corporation. As to the characteristics of an association, see also sections 29.3797-2 and 29.3797-3. The following examples will illustrate some phases of these distinctions:

(1) If A and B buy some acreage for the purpose of subdivision, they are joint adventurers, and the joint venture is classified by the Code as a partnership.

(2) A, B, and C contribute $10,000 each for the purpose of buying and selling real estate. If A, B, C, or D, an outside party (or any combination of them as long as the approval of each participant is not required for syndicate action), takes control of the money, property, and business of the enterprise, and the syndicate is not terminated on the death of any of the participants, the syndicate is classified as an association.

SEC. 29.3797-5. *Limited Partnerships.*—A limited partnership is classified for the purpose of the Internal Revenue Code as an ordinary partnership, or on the other hand, as an association taxable as a corporation, depending upon its character in certain material respects. If the organization is not interrupted by the death of a general partner or by a change in the ownership of his participating interest, and if the management of its affairs is centralized in one or more persons acting in a representative capacity, it is taxable as a corporation. For want of these essential character-

istics, a limited partnership is to be considered as an ordinary partnership notwithstanding other characteristics conferred upon it by local law.

The Uniform Limited Partnership Act has been adopted in several States. A limited partnership organized under the provisions of that Act may be either an association or a partnership depending upon whether or not in the particular case the essential characteristics of an association exist.

SEC. 29.3797-6. *Partnership Associations.*—A partnership association of the type authorized by the statutes of several States, such, for instance, as those of the State of Pennsylvania (Purdon's Penna. Stat. Ann., (Perm. Ed.), Title 59, ch. 3), having by virtue of the statutory provisions under which it was organized, the characteristics essential to an association within the meaning of the Internal Revenue Code, is taxable as a corporation.

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